

Internal Revenue Service
Appeals Office
701 Market St., Suite 2200
Philadelphia, PA 19106

Release Number: **201013074**
Release Date: 6/11/10
Date: March 19, 2010

A

B

UIL – 0501.03-00

Department of the Treasury

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

EO Determination

Tax Period(s) Ended:

UIL: 501.03-00

Form Required to be Filed:

Employer Identification Number:

**Last Day to File a Petition with the
United States Tax Court:**

Not Applicable

JUN 17 2010

Certified Mail

Dear

This is a final adverse determination as to your exempt status under section 501(c)(3) of the Internal Revenue Code (IRC). It is determined that you do not qualify as exempt from Federal income tax under IRC Section 501(c)(3) effective December 31, 2007.

Our adverse determination was made for the following reason(s):

You have not demonstrated that you are organized and operated exclusively for charitable, educational, or other exempt purposes as required by section 501(c)(3) of the Internal Revenue Code. Your operation of bingo games and sale of pull-tabs is your primary activity. These activities are conducted regularly several times a week and year-round. Your education activities are insubstantial and conducted on an irregular and infrequent basis and participated in by only a very small number of your members. Therefore, you are not an organization which operates exclusively for one or more of the exempt purposes which would qualify it as an exempt organization.

Contributions to your organization are not deductible under Code section 170.

You are required to file Federal income tax returns on the form indicated above. You should file these returns within 30 days from the date of this letter, unless a request for

an extension of time is granted. File the returns in accordance with their instructions, and do not send them to this office.

You have waived your right to contest this determination under the declaratory judgment provisions of Section 7428 of the Code by your execution of Form 906, Closing Agreement Concerning Specific Matters, an executed copy of which is being sent to you under separate cover.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, formal appeals process, etc. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. See the enclosed Notice 1214, *Helpful Contacts for Your "Notice of Deficiency"*, for Taxpayer Advocate telephone numbers and addresses.

If you have any questions, please contact the person whose name and telephone number are shown above.

Sincerely,

CHARLES FISHER
TEAM MANAGER

Enclosure:

Notice 1214 – Helpful Contacts for your 'Deficiency Notice'



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date:

FEB 3 2009

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

M = Society
N = Camp
X = Veterans
Y = Combatant
Z = War

UIL:

501.03-00
503.05-00

Dear

We have considered your application for recognition of exemption from Federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issue

Does the applicant, M, qualify for exemption under section 501(c)(3) of the Code, or is exemption precluded by the fact that applicant's primary activity is the conduct of a trade or business for profit?

Facts

You, M, were incorporated in June as a nonprofit corporation under the name N. You stated that you were originally "chartered" in and operated as an unincorporated association before. Originally, you were funded largely by membership dues, however, you decided to start using bingo as a means of fund-raising in. You indicated that you are an official chapter of the X, which holds a group exemption under Code section 501(c)(3). You stated, however, that your parent organization advised you in 20 that you cannot be covered under their group exemption due to your involvement in bingo. You state that X has several other chapters in your state, but that you are the only chapter using bingo for fundraising. In 20, you filed an amendment with the State of, that changed your name to M.

You are a membership organization whose membership is limited to male descendants of members of Y military or governmental organizations. You also have an "associate member" category, which does not require such descent.

According to the laws of your state governing bingo and raffles, no person except an "active member of the organization to which the license is issued" or an auxiliary organization is allowed to "hold, operate, or conduct any games of chance under this license." The only exception is for persons who are bookkeepers or accountants.

You advised that you have one life member, 17 regular members, and two associate members. Associate members are usually persons researching their Y lineage. However, you have also classified an unspecified number of persons who work as paid employees in your bingo operations as associate members. You stated that these individuals hold membership "strictly for bingo operations," that they cannot vote or hold office, and that you are unable to provide specific information on the number of such "associate members" over the years due to frequent turnover among bingo workers. You stated in a letter sent with Form 1023 that you usually have around 7-10 workers per bingo session, working on a rotating basis. According to a copy of a State report that you provided for one month in , at that time, you had 15-16 bingo workers in the "associate member" category, in addition to a non-member bookkeeper. One of your officers serves as "Bingo manager." Around half of your bingo workers at that time had been "members" of your organization for one year or less.

You sponsor bingo games three nights per week, year-round, except on certain holidays. You also sell pull-tabs during bingo sessions. These games are held in a commercial "bingo hall" also used by other organizations that sponsor bingo. You also purchase or rent bingo and pull-tab supplies and equipment from the owner of the bingo hall. You pay a fixed rate per session for use of these premises.

According to income statements sent after Form 1023 was filed, during the years ended through (bingo and pull-tabs) totaling \$

Your total expenditures over this period totaled \$. Of this amount, payments identified as "charity" or "charity donations" totaled \$ consisting of \$ in 20 and \$ in 20 . There were no "charity" payments in 2004 or 2005. Payments for bingo and pull-tabs prizes totaled \$, averaging around % of gross receipts each year. Other expenses identified as relating to gaming (rent, security, bingo workers' salaries, supplies and equipment, etc.) totaled \$. Substantially all other expenses either related to gaming operations or were not sufficiently identified to determine whether they related to gaming or to your stated educational purposes. Your net income after all expenses, including charity payout, averaged around \$ per year. You indicated in your application that you had no physical assets and less than \$ in cash when you filed Form 1023.

Revenues from pull-tabs accounted for % of gross receipts. You indicated that the number of workers selling pull-tabs varies from session to session. The financial information you provided did not provided any breakdown of expenses relating to pull-tabs operations in 20 or ; in and , pull-tab supplies and equipment rental were listed; but all salaries were reported as

"bingo." In Form 1023, you characterized all of your gaming revenues as receipts from activities relating to your exempt purposes.

Although you did not provide sufficient information to determine a completely accurate allocation of expenses between bingo and pull-tabs, the available information tends to indicate that your pull-tabs sales require minimal additional resources, since you use the same premises and workers as for your bingo games. After subtracting prize payout and expenses specifically identified as relating to pull-tab operations, your net income from pull-tabs constituted almost \$_____ over the four-year period 20____ through 20____. In 20____ alone, net income from pull-tabs was over \$_____. It appears that you have not been paying taxes on any of your income.

You reported no sources of income other than bingo and pull-tabs in your financial statements, either in Form 1023 or in subsequent correspondence. In your letter dated July _____, you stated that you had a separate "membership account" to collect dues from your members, and that a portion of these dues is remitted to your national organization, however, you did not provide any income and expense information for this account. On your page on your State organization's website, you stated that dues are currently \$_____ per year after a one-time \$5 registration fee, and that these dues are used, in part, to provide a subscription to a bi-monthly magazine. Based on the information you provided concerning the number of members you have, it appears that membership dues would produce no more than a few hundred dollars a year, accordingly, omission of this income does not materially affect the above computations.

Based on the figures you provided, at least \$_____ was spent in the conduct of gaming activities over the last four years, representing _____% of your gross receipts. Less than _____% of your funds were documented as having been used for "charity." Most unclassified expenses, such as accounting fees, bank charges, and returned check fees, also appeared to relate primarily to your gaming activities.

You did not provide a specific narrative description of your activities in your initial application Form 1023. You provided only copies of your articles of incorporation and bylaws and a copy of a 1996 "amendment" stating that funds raised from bingo were to be used for "donations to persons, organizations, training, education, re-enactment events, insurances for re-enactors, per diem, travel, and cultural events." You stated in a letter sent with Form 1023 that you "promote Z education to the general populace, food to the needy, and assistance to Y and [other] re-enactors."

In a letter dated _____, you were asked where your administrative activities are conducted; however, you provided only a copy of your lease for bingo operations. In response to another inquiry, concerning compensation, you stated that all salaries paid are for work related to bingo.

In our _____ letter, you were also asked to provide more detail concerning your overall activities, especially those activities related to your stated charitable and educational functions. You stated that you make one-time cash payments of \$_____ to widows of your members; that you make donations to other organizations of up to \$_____ (as an example, you mentioned a "shooting club"); that you pay up to \$_____ a year to "the lodge where we hold our meetings;" that you may pay up to \$_____ for accident insurance for organizations involved in re-enactments, that you provide funds for supplies, lodging and *per diem* costs for individuals involved in re-enactment events; and that you "provide monies to the hospitals, the sick, for Z monuments and Y graves."

In our letter dated July 11, , you were asked how many of your members generally participate on a regular basis in activities that you conduct other than bingo; how often you hold membership meetings or other functions for your members; and where such activities are held. We also asked you to indicate how much of your funds were used for these activities in the last three years, and to show where these expenditures were reflected in your financial statements.

You stated that three of your members are re-enactors and that you are "assisted by others" in re-enactment events, living history events, and other unspecified "cultural events." You stated that you also provide data to the State concerning soldiers killed in [other] wars and that you aid in locating Z graves in your state, and provide research services through your website. However, you have only a webpage on your State organization's website, and this indicates that research services are actually provided by the State organization. You stated that "in most cases" you hold monthly meetings, either at members' homes or at the facilities of another organization where your Commander is a member. You stated that your other activities may take place at various locations in your State or in other states. You did not indicate how many of your members generally participate in the different activities, or how often these activities are typically conducted, and did not provide any of the information we requested concerning funds used for these purposes.

You host bingo games three nights a week throughout the year. You hold membership meetings, at most, once a month, and participate in other educational and historical functions on an irregular basis. It is unclear how many of your full members regularly participate in these activities; however, several members are regularly and actively involved in the conduct of gaming and administrative functions relating to gaming activities. Most of your "associate members," who account for around half of your total membership, are bingo workers who are not otherwise involved in your activities, and presumably do not meet your regular membership requirements.

Law

Section 501(c)(3) of the Code provides, in part, for the exemption of corporations organized and operated exclusively for charitable or educational purposes no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that to be exempt under section 501(c)(3) of the Code an organization must be organized and operated exclusively for one or more of the exempt purposes described in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(c)(1) of the Income Tax Regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purpose only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(a)-1(a)(3)(iii) of the regulations provides that an organization described in section 501(c)(3) shall submit with, and as a part of, an application filed after July 26, 1959, a detailed statement of its activities.

Rev. Proc. 2008-9, 2008-2 I.R.B. 1, in Section 4.01, provides that the Internal Revenue Service will recognize the tax-exempt status of an organization only if its application and supporting documents

establish that it meets the particular requirements of the section under which exemption from federal income tax is claimed.

Section 1.501(c)(3)-1(e)(1) provides that a section 501(c)(3) organization may not be operated for the primary purpose of carrying on a trade or business.

Regulations 1.501(c)(3)-1(d)(2) provides that a trade or business is "substantially related" to exempt purposes when the business activity has a substantial causal relationship to the achievement of the exempt purposes. Moreover, the conduct of the trade or business from which income is derived must contribute importantly to the accomplishment of the organization's exempt purpose.

Regulations 1.513-1(b) provides that the term "trade or business" has the same meaning it has in section 162 and generally includes any activity carried on for the production of income from the sale of goods or the performance of services.

Code section 513(c) states, in part, for purposes of this section, the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services. For purposes of the preceding sentence, an activity does not lose identity as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization.

Code section 513(f) provides that certain bingo games are excluded from the definition of unrelated trade or business for purposes of imposition of tax. Regs. 1.513-5(d) defines a bingo game as a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, bingo game means any game of bingo of the type described above in which wagers are placed, winners distributed in the presence of all persons placing wagers in that game. This exception does not apply to "pull tabs" or similar games of chance.

Code Section 513(a)(1) describes certain exceptions that indicate what is not considered an unrelated trade or business. These provisions state, in relevant part, "...the term does not include any trade or business—(1) in which substantially all the work ...is performed...without compensation...".

Church in Boston v. Commissioner, 71 T.C. 102, 107 (1978) provides, in part, that the word "exclusively" does not mean "solely" or "without exception." an organization which engages in nonexempt activities can obtain and maintain exempt status so long as such activities are only incidental and insubstantial (World Family Corp. v. Commissioner, T.C. 958, 963 (1983)). Neither the Code, Regulations, nor case law provide a general definition of "insubstantial" for purposes of 501(c)(3). This is an issue of fact to be determined under the facts and circumstances of each particular case.

In Help the Children, Inc. v. Commissioner, 28 T.C. 1128 (1957) the court held that the organization was primarily operated to engage in commercial bingo activities for profit. Furthermore, the major portion of its contributions were for noncharitable purposes. Therefore, the organization did not qualify for exemption under Code section 501(c)(3).

In P.L.L. Scholarship Fund v. Commissioner, 82 T.C. 196(1984, the Tax court held that an organization that operated bingo games to provide funds for scholarships did not qualify for exemption under Code section 501(c)(3). The organization's bingo games produced minimal net profits for scholarships and served as a means of attracting patrons to a business operated by its founders.

In Make a Joyful Noise, Inc. v. Commissioner, T.C. Memo 1989-4, 56 TCM 1003 (1989), the court held that operating regularly scheduled bingo games on behalf of other exempt organizations was a trade or business unrelated to the organization's exempt purposes. The court held that the organization had failed to carry its burden of proving that its participation in bingo games was an insubstantial part of its activities.

Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945) holds that an organization that educates the public and local businesses about honest business practices has a purpose to advance the members' business as well as an educational purpose. When an organization carries out a non-exempt purpose, substantial in nature, it will destroy the exemption regardless of the number and importance of the truly exempt purposes.

In Revenue Ruling 73-127, 1973-1 C.B. 221, it was held that an organization operating a "cut-rate" grocery store serving residents of a poverty area, in which some employees were disadvantaged persons undergoing job training, did not qualify for exemption. While the job-training phase of the operation was held to be charitable, it was concluded that the primary purpose of the organization was the operation of a trade or business, notwithstanding the absence of profit.

Application of Law

While your stated purposes are educational within the meaning of Code section 501(c)(3), and you do engage in activities that further these educational purposes, you have not demonstrated that either the time or funds devoted to such activities are sufficient to support a conclusion that you are operated "exclusively" for exempt purposes. Even if one adopts a "best case scenario" and assumes that all expenditures not clearly connected to gaming activities are exempt function expenditures, less than 10% of your gross receipts were used for exempt purposes over the last four years. The actual figure appears to be closer to 1%. You were asked several times to provide more detailed information and documentation concerning the amount of both time and funds spent in educational activities, and how many of your members participate in these activities, but provided no specific information. Your classification of bingo workers as "associate members" also appears to be an attempt to circumvent State law regulating bingo operations.

You are similar to the organizations described in *Make a Joyful Noise, Inc., v. Commissioner*; *Help the Children, Inc. v. Commissioner*; and *P.L.L. Scholarship Fund v. Commissioner*. These cases involved organizations engaged primarily in fund-raising activities through bingo games.

The courts held that none of these organizations qualified for exemption under section 501(c)(3) of the Internal Revenue code because they were not operated exclusively for exempt purposes.

As in the *Better Business Bureau* case, your non-exempt activities of conducting bingo games are more than an incidental and insubstantial part of your overall activities. Like the organization discussed in Revenue Ruling 73-127, your business activities exceed the scope of being merely an adjunct to your educational and charitable activities.

Applicant's Position

You contend that your purposes and activities are exclusively educational and that your bingo operations are merely a means of raising funds for your exempt function activities such as participating in reenactments, research, and supporting and participating in your parent organization's educational projects.

Service Response to Applicant's Position

Your gaming operations are not merely incidental to your exempt functions. Bingo and other gaming activities are conducted several times a week, year-round, by a paid staff that substantially exceeds your active *bona fide* membership. In contrast, your educational activities are, for the most part, conducted on an irregular and infrequent basis, and participated in by only a small number of your members. The available information indicates that operation of bingo games (and associated sale of pull-tabs) is your primary activity, and that gaming activities are not primarily conducted as a means of raising funds for educational functions. This is evidenced by the fact that bingo games have produced minimal net profits and that you were unable to show that any significant amount of bingo proceeds were used for exempt purposes in several years, yet you have continued to operate bingo games for more than ten years.

Conclusion

We conclude that you, M, do not qualify for exemption under Code section 501(c)(3), on the grounds that you are primarily operating a trade or business.

Appeal Rights

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office.

You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Robert S. Choi
Director, Exempt Organizations
Rulings & Agreements

Enclosure, Publication 892